No. 83-2001 (2)

In the Supreme Court
OF THE
United States

October Term, 1983

Gweldon Lee Paschall, et al.,
Petitioners,

vs.

The Kansas City Star Company,
Respondent.

On Petition for a Writ of Certiorari to the Court of Appeals for the Eighth Circuit

MOTION OF THE SMALL BUSINESS LEGAL DEFENSE COMMITTEE FOR LEAVE TO FILE AMICUS CURIAE BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI AND APPENDED AMICUS CURIAE BRIEF IN SUPPORT OF CERTIORARI

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MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

The Small Business Legal Defense Committee ("SBLDC") hereby moves pursuant to Rules 42 and 36 for leave to file a brief *amicus curiae* in support of the petition for a writ of certiorari. The consent of petitioners has been obtained. The consent of respondent was requested. In response, respondent advised that it would not oppose or consent to the filing of this brief.

SBLDC is a non-profit association of small business members, many in the distribution trades, from throughout the United States. SBLDC works for governmental policies that facilitate the growth of small business and, in particular, that are consistent with the Small Business Economic Policy Act of 1980 (5 U.S.C. Sec. 631(a)). That act requires

the federal government to "foster the economic interests of small business . . . assuring that adequate capital and other resources at competitive prices are available to small business, [to] reduce the concentration of economic resources and expand competition, and provide an opportunity for entrepreneurship, inventiveness, and the creation and growth of small business."

The basic issue posed by this case is of deep concern to small business people. It concerns the power of a dominant firm to cut off the small businesses to which it had been selling in order to expand its monopoly downstream. This question has implications extending far beyond the particular situation and industry now before the Court. It has potential impact upon all franchisees and other buyers of any firm dominant in its industry and, thus, potential application to many SBLDC members. Accordingly, as a spokesperson for small businesses, which regularly supports their interest in legislative and litigation matters (including a prior *amicus* appearance here), SBLDC desires the opportunity to present its views to the Court.

General representation of small business interests is especially important here because the court below did not rely solely on the record, the statute and the case law; as the *en banc* opinions show, the majority was strongly influenced by the policy implications that it found in what it labelled "optimum monopoly price theory", supported by leading exponents of "Chicago School" economics. Petitioners will necessarily concentrate on the peculiar facts of their own case. But given the significance below of nonrecord theoretical economics, adequate consideration of the importance of the case and the appropriateness of

certiorari requires knowledgeable argument about the economic thinking which influenced the outcome below.

SBLDC, in the interest of small business generally, will argue both that deductive syllogisms drawn from economics should seldom if ever overbear the facts, the legislative history and the precedents, and that, in any event, the Eighth Circuit in this particular case got the economics badly wrong.

In the brief tendered with this motion, the SBLDC treats these problems in a generic fashion not accessible to attorneys that must concentrate on the interests of the particular parties. Specifically, the brief emphasizes relationships between precedents, legislative history and economic theory that are under stress in antitrust law generally and which make this case a uniquely suitable one for the Court to address antitrust issues of profound importance. SBLDC's contribution should assist the Court in setting the problems here presented in a broader context, thus ensuring a readier grasp of the grave import this decision may have for small businesses throughout the country.

Respectfully submitted,

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BRIEF OF THE SMALL BUSINESS LEGAL DEFENSE COMMITTEE, AS AMICUS CURIAE, IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

This brief is filed contingent upon the granting of the foregoing motion for leave to file it. That motion sets forth the interest of *amicus curiae* in this case.

ARGUMENT

As the petition for certiorari shows, respondent (the "Star") having unlawfully obtained its newspaper publication monopoly, terminated its independent carriers in order to monopolize distribution as well. The Eighth Circuit majority held that this conduct did not violate Section 2 of the Sherman Act (15 U.S.C. Sec. 2). Doing so, it made four egregious errors.

First, it failed to recognize the difference between a deductive theory and a record fact. There had been findings in the trial court (based on substantial evidence of change in market structure, and examples of market conduct both before and after that structural change) showing significant injury to consumer welfare when the Star substitutes absolute monopoly for potential competition at the retail level. The majority took note of these findings, but ignored the record evidence on which they were based and labelled the findings an "economic theory". It then went on to assert that this trial court "theory" ought to be evaluated against an alternative "Chicago School" theory. The latter, however, was not derived from empirical facts of record, but rather from textbook assumptions about markets in general (assumptions never shown to be met in this market) and from logical deductions that would have validity only if the underlying assumptions were, in fact, met.

Second, the majority got its own economics woefully wrong. It noted that its "optimum monopoly price theory" indicates that a monopolist can increase its profits through vertical integration only in three circumstances: when entry barriers are increased through integration; when integration facilitates discrimination in price; or when integration aids avoidance of price regulation. But the majority erroneously concluded that none of these conditions were in fact met in the case before it. Actually, the Star's admitted goal—to keep the retail price constant in the face of differing distribution costs—is a classic example of price discrimination in the economic sense (the only kind of discrimination that the court's own theory is concerned with). Also, the majority's conclusion that entry barriers

were not being raised ignored the difference between absolute monopoly and potential competition. After the Star displaces the carriers the possibility of entry at the distribution level is ended; there will be no competitive constraint against full monopoly pricing by the Star. Before the carriers are displaced they face the competitive risk of entry by the Star and can not charge the full monopoly price. Thus, the majority's optimum monopoly price theory, if properly applied, was not inconsistent with the trial court result. Indeed, if the majority had properly applied its own deductive theory it would have found confirmation for the trial court findings.

Third, the majority overreacted to its economic conclusion, even if the conclusion itself were assumed to be right. The majority asked a "rule of reason" question: does the carrier structure or the integrated structure yield the lowest consumer prices and best service? Proceeding to balance, the majority first erroneously concluded that the optimum maximum price theory did not independently show significant competitive harm. But even that erroneous conclusion still left the rule of reason balance heavier on the side of competitive harm. As the majority recognized, the loss of potential competition constitutes harm. Its own erroneous economic analysis did not counter this; it merely failed to provide independent theoretical confirmation of harm. How that lack of additional confirmation of harm was converted into a competitive benefit is simply never explained either in the opinion itself or in any of the theoretical sources cited in the opinion.

Finally, in the course of its "balancing" the majority totally ignored that the Star plans to substitute a closed market for a market accessible to hundreds of independent

businessmen. Since no efficiencies will be gained, even the most austere commitment to efficiency-oriented antitrust analysis would count this effect as negative in the balance. Overall, there are two competitive harms and no benefit, even giving the majority's erroneous economics full credit.

Given these flaws in the *en banc* decision, the petition should be granted for the three reasons argued below.

I

THE PETITION SHOULD BE ALLOWED BECAUSE THE DECISION BELOW COMPOUNDS CONFUSION ABOUT THE SCOPE OF A MONOPOLIST'S DUTY TO DEAL WITH INDEPENDENT FIRMS AT OTHER VERTICAL LEVELS

This Court has in sweeping terms forbidden the use of power in one market to gain power in another. *United States v. Griffith,* 334 U.S. 100 (1048). Twice the Court has applied that principle when a firm with power at one vertical level refused to deal with firms at another in order to extend its power to the second vertical level. *Eastman Kodak Co. v. Southern Photo Materials Co.,* 273 U.S. 359 (1927); *Otter Tail Power Co. v. United States,* 410 U.S. 366 (1973). (In *Otter Tail* the Court also noted the inappropriateness of relying on theoretical studies not supported by the record. Id at 381.)

Despite these authorities, doubt remains about the factors needed to bring this "leverage" rule into play when a dominant firm terminates independent distributors to integrate forward; indeed, the issue "is one of the most unsettled and vexatious in the antitrust field. . . ." *Byars v. Bluff City News Co., Inc.,* 609 F.2d 843, 846 (6th Cir. 1979).

At the level of general doctrine, the majority below made legality turn on the presence of explicit competitive injury that hurts consumer welfare in the short run: if the carrier structure yielded lower prices and better service to consumers than the integrated structure, then refusing to supply carriers violated the law; otherwise not. Other circuits have indicated that deliberately moving a monopoly downstream should be *per se* or presumptively unlawful because it inevitably tends to reduce the down stream competitive stimulus both to innovation and cost reduction. *Six Twenty-Nine Productions, Inc.*, 365 F.2d 478 (5th Cir. 1966); *Packaged Programs, Inc. v. Westinghouse Broadcasting Co.*, 255 F.2d 708 (3rd Cir. 1958). Cases implying various points of view are collected in *Byars v. Bluff City News Co., supra,* at 855-859. (Commentary includes approaches based on the "Chicago School" (e.g. R. Bork, *The Antitrust Paradox* 242-243 (1978); R. Posner, *Antitrust Cases, Economic Notes & Other Materials* 704-708 (1974), the "Harvard School" (e.g. P. Areeda & D. Turner *Antitrust Law* 725-726 (1978); and eclectic literature. E.g. Scherer, *Industrial Market Structure and Economic Performance* 302-306 (2d ed. 1980); Porter, *Competitive Strategy* 191-214 (1980) (negativing the prospects of efficiencies through substituting bureaucratic for market organization in a fragmented industry, such as retailing newspapers); Handler, Blake, Pitofsky and Goldschmid, *Trade Regulation, Cases and Materials* 721-728 (2d ed 1983)).

Conflict in this important area of the law would alone make certiorari appropriate. But here, the *Kodak-Otter Tail* principle was rejected in the face of a trial court finding of competitive injury and despite the lack of any

efficiency gains. Confusion was compounded and converted into an injustice; the *en banc* majority not only eschewed the *per se* and presumptive approaches, it held for the monopolist on a record that supported a plaintiff's verdict on any credible view of the law. And it took this course to the advantage of an already-convicted monopolist and at the expense of hundreds of independent business people.

The minimum teaching of *Eastman Kodak* and *Otter Tail* is that refusal to deal by a monopolist violates Section 2 when the evidence shows a competitively harmful effect. Such an effect arose here because the change imposed by the Star substituted unconstrained monopoly for a structure in which potential competition protected consumers. Against this finding the Eighth Circuit balanced nothing save a sweeping, deductive generality: that except in circumstances the majority erroneously thought not present here an upstream monopolists can only gain one monopoly profit and, therefore, that the monopolist in integrating downstream must have efficiencies in view. If that generalization were here to overbear the contrary finding about competitive injury and efficiency, then *Eastman Kodak* is effectively overruled, and *Otter Tail* confined to its own narrow, regulatory context.

By ignoring that the Star gained its publication monopoly unlawfully, the Eighth Circuit also misconceived the significance of this Court's "essential facilities" cases, *United States v. Terminal Railroad Association,* 224 U.S. 383 (1912) and *Associated Press v. United States,* 326 U.S. 1 (1945). Those cases hold that where the ability to participate in a market depends upon access to a service or product that defendants have obtained concertedly, then

defendants may not deny access. Here, the essential facility was the newspaper, the only one in the market. It was not controlled concertedly, but by the Star alone. Thus, if the Star was a lawful monopolist, the essential facility cases would have no implication; a firm that has gained a position of power lawfully may exploit its product alone. But the Star was not a lawful monopolist; it gained power by predation. If gaining power through cooperation with others, as in *Terminal Railroad* and *Associated Press,* ends the right to exploit power to the exclusion of others, surely that right is also ended when, as here, a single firm gains its power by unlawful, predatory means. A lawful monopolist is free of the constraints of the essential facility cases because the innovation that gained it power must be properly rewarded. But that policy has no application whatsoever to a predatory monopolist whose power must be constrained, penalized and discouraged, not rewarded.

II

THE PETITION SHOULD BE ALLOWED IN ORDER TO CLARIFY THE COMPLIMENTARY ROLES OF EMPIRICAL EVIDENCE AND DEDUCTIVE ANALYSIS OF COMPETITIVE EFFECT

The utility of economics to antitrust is a commonplace. But there are many styles of economics and many judicial economists. Here, encouraged by the Government's *amicus* presentation, the Eighth Circuit treated as legal doctrine a deductive generalization drawn from Chicago school economics. Not only did it substitute theoretical inference for evidence, it did so without inquiry whether the assumptions essential to the theoretical inference were present in the record; and in fact they were not.

The majority's "optimum monopoly price theory" is proxy language for micro-theory based on conventional Chicago assumptions: that all relevant actors are rational; that they are in instantaneous and costless possession of all relevant information; that all producers seek to maximize profits and all consumers seek to maximum utility. See generally G. Stigler, *The Theory of Price* (3rd ed. 1966); C. Ferguson, *Microeconomic Theory* (rev. ed. 1969); A. Alchian and W. Allen, *Exchange and Production: Competition, Coordination, and Control* (2d ed. 1977). Though inevitably arid, such analytical rigor is useful to demonstrate tendencies. But it surely does not justify a court's accepting the results of the theoretical analysis absent proof of the underlying assumptions, and in the face of evidence and findings that belie the theoretical results. Here, the factual evidence that confounded the majority's conclusion was weighty indeed. It showed both a structural change that ended potential competition and a consequential change in pricing policy—a change increasing prices to over ninety percent of consumers.

This lack of accord between the empirical evidence and the majority's theoretical deduction should have been a warning. The majority jumped to the conclusion that its theory was right and the evidence wrong. But there are two other alternatives, neither of which it considered. For one, the tendencies the theory points to (and they are only that) may not have materialized in this instance because one or more of the theoretical assumptions was missing. Perhaps the monopolist did not have complete information. Or perhaps it did not act rationally to maximize. (After all, it is only firms in competitive markets that must be efficient or fail; monopolists have additional options such

as ineptitude, the quiet life, or even expansion into new markets for reasons of ego, comfort and stability and at the expense of some of their monopoly profits.) For another, the majority may have misunderstood and misapplied the theory. This, indeed, is what actually happened. Moreover, if the court had properly applied the micro-theory it purported to use it would have reached the same result as did the trial court.

One blatant economic error by the majority was to think that the potential competition theory (as it called it) was an alternative to the profit maximization thesis. In actuality, the finding about potential competition from the Star simply stated the particular circumstances under which carriers, though "natural monopolists" on each route, were obliged to maximize: the Star's presence obliged carriers to "limit price" in order to discourage entry by the Star rather than to set the full profit maximizing price. See F. M. Scherer, *Industrial Market Structure and Economic Performance* 232-252 (2d ed. 1980). Carriers "profit maximized" by taking account of the threat they faced if they priced too high. This, of course, yielded lower consumer prices than the full profit maximizing monopoly price that the Star after integration is free to charge. Thus, the first of the theoretical conditions for the use of vertical integration to increase monopoly returns was palpably present: entry barriers at the distribution level go up, because potential competition is diminished when the Star replaces its dealers. Indeed, the Star had great control over the intensity of its potential competition. If any carrier priced above cost, the Star could sell itself at lower prices—but only in the densest, lowest

cost portions of the carriers route, thus leaving the high priced carrier with only the remaining high cost portion.

The majority's second error in economic thinking was failing to recognize that price discrimination, the second theoretical condition for increasing monopoly profits by vertical integration, was also present; indeed, it was one of the Star's prime motives for terminating the carriers. Carriers had priced according to the costs on their individual routes—some dense, with low per unit distribution costs, some sparsely populated, with higher per unit costs. On entry the Star will charge a generally higher single price for all readers. The Eighth Circuit supposed that a single price for all readers showed that the Star would not price discriminate. Actually, given the differences in delivery costs between densely and sparsely populated urban areas, the use of one price for all shows precisely the opposite—that the Star will discriminate, and thereby increase its monopoly profit.

Price discrimination in the economic sense, the kind of discrimination that the Court's optimum monopoly price theory is concerned with, occurs upon "the sale of two or more similar goods at prices which are in different ratios to marginal cost." G. Stigler, *The Theory of Price* supra at 209. Such discrimination occurs if the seller either charges different prices where all costs are the same or charges the same price in the face of different costs. Here, once it integrates forward, the Star is supplying not just a newspaper, but also "place utility"; it is putting the paper at the reader's door. This service has higher costs on sparse suburban distribution routes than on dense urban distribution routes. These differing costs and values

had been reflected in carrier pricing. But the Star's single price changes that. It establishes a discriminatory pricing system in which low cost urban readers cross-subsidize the high cost suburban readers by paying the same price in the face of cost differences. Inferentially, the Star's single price is high enough to cover costs on high cost routes; thus, it leads to increased monopoly returns on densely populated routes where costs were lower.

The majority in defending downstream monopolization stressed that most newspaper advertising revenues are a function of total circulation; on this basis the majority deduced that the Star had an additional incentive to keep resale prices down. Once again, the court's economics is questionable; there is neither a theoretical nor an evidentiary basis for supposing that the Star, as a dual product (advertising and newspaper) monopolist, would set a lower profit maximizing price for papers than would the carriers who, though selling only one product, did so under threat of potential competition.

First, as to theory: A newspaper monopolist wants to maximize total revenue. It faces some competition from other media for national ads—say, ads for G.M. cars—but for ads by local merchants the only newspaper in a metropolitan area has manifest market power. There is a relationship between revenue from ads and total circulation, but the price on local ads can include a monopoly return. And the tradeoff between, on the one side, monopoly returns from local ads and more normal returns from national ads and, on the other side, monopoly returns from newspaper sales could hardly result in competitive, marginal cost pricing on the sale of papers. Just how high

the price of the paper will be depends, ultimately, on the relationship between circulation and advertising revenues and on the comparative price elasticities of demand for advertising and demand for the paper. If (as seems intuitively likely) the only paper in the Kansas City market could raise prices significantly above delivery cost without substantially reducing aggregate readership, and could also lose a few readers without greatly reducing local advertising revenue, then that paper, when integrated forward, will have an obvious incentive to engage in monopoly pricing.

Second as for the evidence: The Star's entry is not yielding reduced paper prices, larger circulation and higher ad revenues. What is happening is that the Star is raising newspaper prices and, so far as appears, doing so without significant reduction in circulation at all. Thus, monopoly returns on paper sales are added to monopoly returns on ads. The record flatly rebuts any claim that the Star, by integrating forward, is protecting newspaper buyers from monopoly prices. The exact opposite appears.

The majority's repeated economic errors make certiorari particularly appropriate. In antitrust cases generally, lower federal courts, following the lead of this Court, are turning increasingly to economic theory. But when they do, confusion—sometimes, as here, the grossest kind of economic misapprehension—can follow. As prime custodian of the antitrust tradition this Court should grant certiorari here to correct manifest injustice and to rectify some bad economics that the Eighth Circuit has transformed into incredibly bad law.

III

THE PETITION SHOULD BE ALLOWED IN ORDER TO SHOW THAT PROTECTING MARKET ACCESS IS AN ANTITRUST GOAL ESPECIALLY WHERE, AS HERE, THERE IS NO OFFSETTING LOSS OF EFFICIENCY

In passing the Sherman Act Congress recognized that monopoly hurt consumers by increasing prices; it also had an "at least equal concern with the fate of small producers driven out of business." C. Kayen & D. Turner, *Antitrust Policy, An Economic and Legal Analysis* 19 (1965). As of 1965 these authors could say that this "second historic aim of antitrust policy—that of preserving the opportunities of smaller businesses competing with, buying from, or selling to the monopolist—has retained continuing validity." (Id. at 22.) The antitrust goal of preserving markets accessible to small entrants was reflected in numerous cases in which this Court emphasized that antitrust is a many-valued tradition. E.g. *Northern Pacific Railway Co. v. United States,* 356 U.S. 1, 4-5 (1958); *Brown Shoe Co. v. United States,* 370 U.S. 294 (1962). Indeed, preserving markets open to small traders had a political as well as economic rationale: to assure a free polity the nation also needs a free economy with many independent decision makers, each with his own capital at stake. See Pitofsky, *The Political Content of Antitrust,* 127 U. Pa L. Rev. 105 (1979); Blake & Jones, *Toward a Three-Dimensional Antitrust Policy,* 65 Colum. L. Rev. 422 (1965); *In Defense of Antitrust,* 65 Colum. L. Rev. 363 (1965).

Recently lower courts have downgraded the "second historic goal"; they have hesitated to restrict actions by monopolists that reduce opportunities of smaller firms when doing so may reduce the monopolists' efficiency. E.g.

Berkey Photo, Inc. v. Eastman Kodak Co., 603 F. 2d 263, *cert. denied*, 444 U.S. 1093 (1980). But until the Eighth Circuit's decision below no case has ever acted as though preserving markets accessible to small firms is not an antitrust goal at all. It is one thing to trade off free access to markets in the interest of efficiency. But to ignore the conversion of an open, multi-firm market into a monopoly when no efficiencies are gained, monopoly returns increased, and consumer welfare reduced is not to engage in a balancing process; it is to surrender significant antitrust values for no return at all.

Yet that is the precise effect of the decision below. The Star says it is seeking efficiencies. The majority by misusing theory may have erroneously concluded that whenever an unregulated monopolist integrates forward it must be to obtain efficiencies. But there was no record evidence that efficiencies are obtained, and no finding of efficiencies. Yet, hundreds of carriers are being forced out of the market to smooth the path by which an unlawful monopolist increases its monopoly returns.

Indeed, there is evidence that the Star knew it could not distribute papers more efficiently than the carriers. It could hardly be otherwise. Newspaper distribution has traditionally been a highly fragmented market. See generally, B. Compaine, *The Newspaper Industry in the 1980's: An Assessment of Economics and Technology* (1980). The most credible analysis suggests that in such a fragmented market substituting monopoly (with hierarchical supervision and decision making) for small firm market organization is unlikely to yield efficiencies. See M. Porter, *Competitive Strategy, Techniques for Analyzing Industries and*

Competitors, Chap. 9 (1980). Newspaper retailing has a high content of unskilled labor and a low content of capital. Such an industry has low entry barriers and an absence of scale economies. It is precisely the kind of market that draws people that "want to be their own boss" and are willing to work long and odd hour for that felicity. Such strongly motivated owner-workers may get adequate returns from their truck and their effort, but there is no rational basis whatever to infer either from theory or from general experience that a hierarchical organization of paid managers and hired hands will be able to get greater output from the same inputs. Indeed, experience and intuition suggest precisely the opposite. Papers must still be picked up and delivered, and "hustle" is still essential; but when the monopolist moves down to the distribution level the spurs of independence and profit for the early morning "hustlers" are gone.

There would have been no antitrust problem if the Star had entered into more vigorous actual or potential competition with these carriers. But absent proof of efficiencies not otherwise obtainable, to allow a convicted monopolist to force hundreds of downstream traders out of the market is anathematic to the antitrust tradition.

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